

Briefing Note

Directors' Duties & Liabilities

This note applies to all the directors of a company. "Director" is defined to include any person occupying the position of director, by whatever name called (section 250 Companies Act 2006 ("CA 2006")), which will include de facto directors. However CA 2006 provides that the duties will only apply to shadow directors to the extent that the corresponding common law rules or equitable principles so apply (section 170(5)).

CA 2006 makes no distinction between executive and non-executive directors. Non-executive directors have the same legal duties and responsibilities as executive directors.

For more information on the various types of directors see our Briefing Note: Directors.

Fiduciary duties

The common law has imposed on all directors' fiduciary duties and a duty of care and skill. Many of those duties are now codified by the CA 2006. Other statutes and regulations create additional offences and many of them impose strict liability.

The fiduciary duty of directors towards a company was a duty to act honestly and in good faith in the best interests of the company, and to use the powers granted to them for the purposes for which they were conferred. CA 2006 codifies some of these duties. In summary, the seven general duties of directors under the CA 2006 are:

- To act within powers.
- To promote the success of the company.
- To exercise independent judgment.
- To exercise reasonable care, skill and diligence (a standard of skill and care, not a fiduciary duty, see below).
- To avoid conflicts of interest.
- Not to accept benefits from third parties.
- To declare an interest in a proposed transaction or arrangement.

Other statutory obligations

Other statutory obligations of directors are contained in the CA 2006 and in other legislation. They include administrative duties such as the duty to keep the statutory books up to date and the duty to file annual returns.

Other legislation that imposes criminal and civil liability on directors includes the Insolvency Act 1986 (for example where a director continues to trade when he knew or ought to have known that there was no reasonable prospect of the company avoiding insolvent liquidation or if he knowingly continues to carry on business with the intention of defrauding creditors in the knowledge that there was no reasonable prospect of the creditors being paid by the company); health and safety regulations and environmental legislation (if it is shown that the director contributed to a breach through consent, connivance or neglect); the Company Directors Disqualification Act 1986 (if a director acts while disqualified); as well as competition and securities law.

Standard of skill and care

Under section 174, a director must exercise the care, skill and diligence that would be exercised by a reasonably diligent person with both:

- The general knowledge, skill and experience that may reasonably be expected of a person carrying out the functions carried out by the director in relation to the company (the "objective" test).
- The general knowledge, skill and experience that the director actually has (the "subjective" test).

So, at a minimum, a director must display the knowledge, skill and experience set out in the objective test, but where a director has specialist knowledge, the higher subjective standard must be met.

Company Directors Disqualification Act 1986 (the "CDDA")

The CDDA is also designed to raise directors' standards and is a powerful tool against those who abuse the privilege of limited liability. Any misconduct of a director may be relevant to the court in determining unfitness and periods of disqualification, not merely those criteria set out in the CDDA. Case law refers to a variety of forms of misconduct including breach of standards of commercial morality; gross incompetence or negligence; danger to the public; gross irresponsibility; and want of commercial probity.

Directors' liability

The courts have not held that directors are guarantors of a company's success. The statutory obligation is that directors act in the way they consider - not what a court may consider - would be most likely to promote the success of the company for the benefit of its members as a whole (section 172(1), CA 2006). Courts have acknowledged that a degree of commercial risk-taking is a necessary part of earning a sufficient return on the capital invested. Further, it has long been accepted that directors are not liable for mere errors of judgment.

While a court may relieve directors from liability if they acted honestly and reasonably it will only do so if, in its opinion, they ought fairly to be excused (section 1157, CA 2006). Prudent directors will take every reasonable step to prevent liability arising. The holding of regular board and other management meetings and reviews, accompanied by clear minutes, have proved in practice to be the best evidence of the steps the directors took, and why.

D&O insurance

Section 233 of the CA 2006 permits a company to purchase and maintain insurance for its directors against any liability attaching to them in connection with any negligence, default, breach of duty or breach of trust by them in relation to the company. Because directors face personal liability in certain circumstances despite the limited liability status of the company, a director should ensure that the company has taken out adequate directors' and officers' liability insurance to cover their potential exposure. Insurance cover is normally purchased by the company but may on occasion be purchased by individual directors.

Please contact Turcan Connell's Business Law team for more information on directors' duties & liabilities.

Please note that this briefing note is intended as a short summary of directors' duties. No responsibility can be accepted for any action taken in reliance on this note and specialist advice should be taken in every case. Turcan Connell would be happy to provide such advice.

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